



The World Bank
Insolvency and Creditor/Debtor Regimes
Task Force Meetings

**UNCITRAL Legislative Guide on Insolvency Law on
the Treatment of Enterprise Groups: Updating the
World Bank Principles**

January 10, 2011
Held at the World Bank
Washington, DC

Rapporteur's Synopsis

By The Hon. Leif M. Clark

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Conference Report: Day 1 – Session 1

**UNCITRAL Legislative Guide on Insolvency Law on the Treatment of
Enterprise Groups: Updating the World Bank Principles**

9:30 – 11:00, January 10, 2011

Chairperson: Jose M. Garrido, World Bank

Speakers: Jose M. Garrido, World Bank
Claudia Gross, UNCITRAL
Riz Mokal, World Bank

**Rapporteur's Synopsis
The Hon. Leif M. Clark, Rapporteur**

Introduction:

This session focused on the work of the World Bank in consultation with the work of UNCITRAL.

Background

[1] The World Bank and the International Monetary Fund, and incident to their work in evaluating the efficacy of laws and systems for the regulation of the financial sector in various countries, conduct Financial Sector Assessment Programs (FSAP). As part of the standards and codes initiative, the World Bank also issues its Reports on the Observance of Standards and Codes (ROSC) on Insolvency and Creditor Rights. It has completed assessments in Cameroon, Kenya, Mauritius, Morocco, Nigeria, Uganda, Zambia, Jordan, South Africa, Burkina Faso, India, Nepal, The Philippines, Sri Lanka, Vietnam, Czech Republic, Kyrgyz Republic, Lithuania, Poland, Romania, Russia, Slovak Republic, Slovenia, Turkey, Ukraine, Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Uruguay, and the Dominican Republic. Assessments are in the final stages for Saudi Arabia, Tanzania, and Thailand. Assessments are underway in Ghana, Rwanda, South Africa, Kenya (an update), Mongolia, Bangladesh, Kazakhstan, Russia (update), Mexico, Peru, and Paraguay.

[2] An important component of these assessments is the measurement of country laws and systems against principles that reflect best practices, so as to maximize a given country's ability to meaningfully participate as a trusted partner in international trade and commerce, and to assure that a country's laws protect both its citizenry and the capital invested in that country. The principles ought to reflect a consensus among a broad spectrum of nations, both developed, developing, and as yet undeveloped. To this end, the World Bank has promulgated Principles for Effective Insolvency and Creditor Rights Systems (ICR).

[3] The World Bank Principles may be broken down into three main components.

[a] Credit Access / Protection (Principles A 1-5)

[b] Credit Risk Management (Principles B 1-5)

[c] Insolvency (Principles C 1-15)

Credit Access and Protection Principles address (1) the compatibility of collateral systems with insolvency systems, (2) collateral systems themselves with respect to both movables and immovables, (3) systems for the registration of interests, including interests in collateral, and (4) enforcement mechanisms with respect to the foregoing systems.

Credit Risk Management Principles address (1) credit information systems, (2) directors and officers liability, (3) risk management practices, and (4) workout frameworks.

Insolvency Principles address (1) corporate exit mechanisms, (2) liquidation regimes, (3) rehabilitation regimes, and (4) implementation mechanisms. With regard to this last category, the principles further address both institutional systems and regulatory systems that may be employed in a given country.

[3] The World Bank Principles must be constantly reviewed and updated in order to keep pace with rapid changes in the trade and investment activity within and among nations. Of particular interest to this working group are the principles relating to insolvency. With regard to the continuing development of these principle, the World Bank has been especially appreciative of the proactive work of the United Nations Commission on International Trade Law, whose Working Group V has promulgated the Model Law on Cross-Border Insolvency, the Legislative Guide on Insolvency Law, and the Practice Guide on Cross-Border Insolvency Cooperation. These documents reflect the work of many nations, and so express a broad consensus on insolvency principles in both developed and developing nations. As such, they also enjoy broad acceptance among many nations.

[4] The World Bank now employs the Insolvency and Creditor Rights Standard (ICR Standard) as its measure for evaluating insolvency regimes as part of its assessment

functions. The ICR Standard is composed of the World Bank Principles for Effective Insolvency and Creditors Rights Systems earlier referenced (2001, 2005), and the Recommendations of the UNCITRAL Legislative Guide on Insolvency Law (2004).

The Work of UNCITRAL on the Treatment of Enterprise Groups

[5] Recently, UNCITRAL, at its July meeting in New York City, adopted new Recommendations relating to the treatment of enterprise groups in insolvency, to be published as Part Three of the Legislative Guide on Insolvency Law. The product was endorsed by the General Assembly of the United Nations in December 2010. The Legislative Guide was negotiated by delegations from 87 nations, 14 intergovernmental organizations, and 13 non-governmental organizations.

[6] The Legislative Guide on Insolvency Law is a tool for those who are drafting or revising insolvency laws. It addresses key issues to be considered in developing an efficient and effective legal framework for an insolvency regime. It aims to achieve a balance between the need for timely and efficient reaction to a given firm's financial crisis, the interests of various constituencies, and public policy concerns (including the needs of employees affected by the firm's insolvency). For example, India is now in the process of reviewing its own laws using the Legislative Guide. The Guide also is an educational tool. A key point is that the Legislative Guide is "soft law," adaptive to many situations.

[7] Part One of the Guide offers guidance on designing the key objectives and structure of an insolvency law. Part Two covers the core provisions that an insolvency law should contain. New Part Three deals with the treatment of enterprise groups in insolvency. The design of the Guide consists of commentary that identifies key issues to be considered, with analysis of various approaches that can be taken. The commentary is then followed by formal recommendations, which indicate the manner in which key issues should be addressed in an insolvency law. The Recommendations represent the formal position of UNCITRAL, but are not intended to be enacted as part of a national law as such. Instead, they provide guidance on the content and approach that legislation should take with respect to each issue so addressed.

[7] Part Three focuses on issues presented when one or more members of an enterprise group is the subject of an insolvency law. Many businesses today are organized as groups of companies (and related legal entities). However, much national legislation relating to insolvency is designed only for a single corporate entity. Recognizing this as a problem that would be an appropriate subject for guidance, the Commission directed Working Group V to take up the problem. The Working Group then commenced work, seeking to offer guidance that would effectively address the issues that might arise for enterprise groups, both domestically and internationally. Working Group V took up the task, and its work is ultimately reflected in Part Three of the Legislative Guide on Insolvency Law, as

adopted by UNCITRAL in July 2010, and endorsed by the General Assembly in December 2010.

[8] With regard to the domestic aspects of insolvency affecting enterprise groups, Part Three is broken down into five major issues:

- [a] Application for relief and commencement of insolvency proceedings
- [b] Treatment of assets upon commencement
- [c] Remedies
- [d] Participants
- [e] Reorganization of two or more group members

With regard to the international aspects, Part Three addresses four topics:

- [a] Promoting cross-border cooperation among enterprise group insolvency proceedings
- [b] Forms of cooperation involving courts
- [c] Forms of cooperation involving insolvency representatives
- [d] Use of cross-border insolvency agreements

[9] The approach taken by Working Group V was to identify issues, and to develop agreed solutions. Virtually all the issues were decided by consensus rather than by binding vote. As a result, the Working Group strived to resolve differences of opinion in a consensual fashion that fairly reflected the interests of all the delegations. With regard to the domestic aspects of enterprise groups, the approach of the Working Group was to first determine whether the existing Recommendations contained in Parts One and Two would be adequate to address the special circumstances presented by enterprise group insolvency. If they were not, then the Working Group took up the task of considering how those Recommendations could be modified to meet the need. With regard to international aspects, the same approach was employed, with the additional consideration of examining and modifying the Recommendations contained in the Model Law on Cross-Border Insolvency for enterprise groups.

[10] An enterprise group is defined in Part Three as two or more enterprises that are interconnected by control or significant ownership. The definition is intentionally broad enough to include entities that engage in economic activity and that may be the subject of an insolvency law, regardless of legal form. Thus, for example, so called “special purpose vehicles” could be included as a members of an enterprise group.

[11] While the legal separateness of the various constituent entities needs to be respected (including the separation of assets and liabilities), there is often a need for coordinated consideration of the companies, including information gathering, noticing, and the like. Part Three makes recommendations (Recommendations 199-201) that address the procedure for making a joint application for commencement of insolvency proceedings by more than one legal entity. The recommendations acknowledge that each of the members of the group, including their assets and liabilities, remains separate and distinct. The purpose of the recommendations is to

provide a mechanism for gathering information on the operations of the enterprise group, for assisting in the valuation and identification of assets, and to avoid duplication of efforts. Recommendations 203-210 address more specific issues relating to procedural coordination, including the all-important issue of affording notice of procedural coordination to all affected constituencies.

[12] In addition, enterprise groups sometimes require one or more members of the group to advance money to one or more other members, to keep the enterprise group functioning for the benefit of all. The actual lender might be a member of the group, or an external lender. In either case, a critical feature of such lending is that it might include a pledge of assets of a solvent member to support lending for the benefit of one or more insolvent members of the group. A solvent member might also expect to receive a priority in exchange for its provision for financing (including a provision for a pledge of its assets or a guaranty). Careful balancing of the adverse impact on the lending entity's creditors with the expected benefit to all creditors needs to be done. The goal is to achieve a fair apportionment of the harm that might be visited on creditors of the group member advancing the financing with the expected long term gain for the enterprise group as a whole. Recommendations 211-216 address these issues. Apart from post-commencement financing, the problem of post-application financing may arise where there is a gap between the time of the application and the opening of the insolvency proceedings: recommendation 39 in Part One of the Legislative Guide may be of assistance in this regard, as it permits courts to order provisional measures to preserve the assets of debtors prior to commencement of insolvency proceedings.

[13] Part Three also addresses the special issues that enterprise groups present with regard to avoidance proceedings. In Part Two of the Legislative Guide, Recommendations 87-99 apply to the avoidance of transactions between group members and an external party. Transfers between group members might not actually be appropriate candidates for avoidance actions, however, if it can be shown that the interests of the group were advanced, then the transfer might not be one that ought to be set aside. Recommendation 217 in Part Three states that a court should take into consideration the relationship between the parties to the transaction, their degree of integration, the purpose of the transaction, whether the transaction made a positive contribution to the operations of the group, and what advantages were conferred on the group that would not normally be granted were the parties unrelated.

[14] Some cases might also be appropriate candidates for substantive consolidation, where the affairs of the members of the group are so intermingled that the cost or delay associated with disentangling the entities cannot be justified, or if there is a fraudulent scheme apparent, with no legitimate purpose, that will be perpetrated unless consolidation is ordered. Substantive consolidation involves treating the assets and liabilities of two or more members of an enterprise group as if they were part of a single insolvency estate, effectively erasing the separateness of the legal

entities. Recommendation 220 states that this remedy ought to be available, but only in very limited circumstances, and should require a showing that the assets and liabilities are so intermingled that their ownership and responsibilities cannot be identified without disproportionate expense or delay or, in the alternative, that members are engaged in a fraudulent scheme with no legitimate business purpose, and that substantive consolidation is necessary to rectify the harm. Recommendation 224 describes the effects of substantive consolidation, rendering the treatment of assets and liabilities of the consolidated members as if they were part of a single estate, with intercompany claims extinguished, and claims against individual members treated as claims against the consolidated entity. Other Recommendations (219-223, 225-231) address such matters as exclusions, timing of an application for substantive consolidation, recognition of priorities, and notice.

[15] Finally, it may be appropriate in some circumstances to consider having one insolvency representative for all members of the group, though conflicts of interest need to be considered. Recommendations 232-233 address these issues. Recommendations 234-236 address cooperation and coordination among two or more insolvency representatives, to the extent possible as otherwise allowed by local law.

[16] Part Three also addresses the issues raised when reorganization of an enterprise group is proposed. Reorganization plans in the group context are intended to facilitate the coordinated rescue of the enterprise group as a whole, and an insolvency law ought to permit such coordinated plans to be proposed. They should also permit the voluntary participation of solvent group members. Recommendations 237-238 address these issues.

[17] With regard to international treatment of enterprise groups, Part Three raises some of the difficult issues that are presented by such cases. In which jurisdiction should such proceedings be opened? Where is the centre of main interests for the group? May a solvent member be included in a reorganization plan for an enterprise group that crosses international borders? These questions pose difficult questions involving jurisdiction, and conflicts of law. It is recognized that a true solution to these problems may not be possible without a legally binding international instrument to regulate the issues of applicable law and jurisdiction.

[18] Part Three, in addressing these difficult questions, seeks to focus on coordination and cooperation, and an extension of the domestic recommendations where possible (including consideration of the principles set out in the Model Law on Cross-Border Insolvency, promulgated by UNCITRAL in 1997). It is generally acknowledged that extending those recommendations with regard to post-commencement financing and substantive consolidation may not be possible, but that recommendations with regard to coordinated reorganization plans, the appointment of a single insolvency representative, and the employment of cross-border insolvency agreements are possible. Recommendations 239-240 speak to access to courts and recognition, as well as cooperation between courts and

between representatives, consistent with the structure set out in the Model Law on Cross Border Insolvency. Recommendations 241-245 address court to court cooperation in the enterprise group context with greater specificity, once again consistent with the Model Law (especially Articles 25-27). Recommendations 246-250 address cooperation between insolvency representatives in the group context, while Recommendations 251-252 address the appointment of a single insolvency representative in the enterprise group cross-border context. Recommendations 253-254 discuss the authority to make and the implementation of cross-border insolvency agreements, consistent with practices outlined in the Practice Guide on Cross-Border Insolvency Cooperation, promulgated by UNCITRAL in 2009.

Updates to the World Bank Principles

[19] The World Bank is updating its ICR Standards to add two new standards, C16 and C17, which summarize the salient points presented in Part Three of the Legislative Guide, and incorporate the Recommendations from that Guide. These standards are appropriate to the work of the World Bank in its Reports on the Observance of Standards and Codes. The new standards are prescriptive in nature. In the context in which the standards are used, this means that the World Bank is assessing insolvency regimes based on the World Bank Principles and on the recommendations of UNCITRAL as expressed in the Legislative Guide. Thus, nations are encouraged to develop or update their insolvency laws to match the World Bank Principles and the recommendations in the UNCITRAL Legislative Guide.

[20] World Bank Principle C16 is entitled “Insolvency of Domestic Enterprise Groups”, and contains six subparts: (1) Procedural Coordination, (2) Post-commencement Financing, (3) Substantive Consolidation, (4) Avoidance Actions, (5) the Insolvency Representative, and (6) Reorganization Plans. C16 states that an insolvency system should specify that the insolvency proceedings with respect to two or more members of an enterprise group may be procedurally coordinated, and that it should permit a member of the group to provide or facilitate financing for post-commencement operations for the group. A system should respect the separate legal identity of members of the group, and should closely restrict the possibility of substantive consolidation to narrow circumstances essentially similar to those set out in Part Three of the UNCITRAL Legislative Guide on Insolvency Law, and should provide adequate treatment for secured claims, priorities, creditors meetings and avoidance actions. By the same token, once substantive consolidation is ordered, the system can treat the resulting entities, their assets and their liabilities, as a single enterprise. With regard to avoidance actions, a system should permit a court to take into account the circumstances of an otherwise avoidable transaction that occurs between members of an enterprise group. The system should authorize the appointment of a single insolvency representative for the group (with appropriate protections), and should also authorize coordinated reorganization plans. It should also permit members of the group that are not debtors to voluntarily participate in the reorganization process. World Bank Principle C16 has appended to it the

relevant recommendations from Part Three of the Legislative Guide on Insolvency Law.

[21] World Bank Principle C17 is entitled “Insolvency of International Enterprise Groups” and contains five subparts: (1) Access to Courts and Recognition of Proceedings, (2) Cooperation Involving Courts, (3) Cooperation Involving Insolvency Representatives, (4) Appointment of the Insolvency Representative, and (5) Cross-border Insolvency Agreements. C17 specifies that an insolvency system should provide foreign representatives and creditors with access to courts, and should also provide for the recognition of foreign insolvency proceedings (if necessary). The system should allow national courts to cooperate with foreign courts and foreign representatives, and should also permit direct communication and direct requests for information and assistance. The system should also permit insolvency representatives to cooperate and communicate with one another with respect to different members of an enterprise group, to facilitate the coordination of the proceedings. The system should also allow for the appointment of a single or the same insolvency representative for members of the enterprise group in different states, with appropriate protections against conflicts of interest. Finally, the system should permit insolvency representatives and other interested parties to enter into cross-border insolvency agreements (in some jurisdictions called “protocols”) involving two or more members of an enterprise group with proceedings pending in different states, to facilitate coordination. The system should also allow courts to approve and implement such agreements. The relevant recommendations from Part Three of the Legislative Guide on Insolvency Law are appended.

[22] As important as is the work of UNCITRAL in providing assistance and guidance on these issues to the World Bank, there is an equally valuable cross benefit in the World Bank’s incorporation of UNCITRAL’s work in its ICR Standards. Because of the important role that these standards play in the World Bank’s Reports on Observance of Standards and Codes, states are encouraged to modify and update their local insolvency laws to conform to those standards, and thus encouraged to employ the World Bank Principles and the Recommendations (and related guidance) in the UNCITRAL Legislative Guide on Insolvency Law. States that might otherwise never consult the Legislative Guide now have a higher motivation to do so in order to meet the standards set by the World Bank.

[23] This is especially relevant with regard to World Bank Principle C17 which, in sub-parts one, two, and five, essentially prescribes the enactment of laws similar to the UNCITRAL Model Law on Cross-Border Insolvency. Versions of the Model Law have been enacted by a number of nations, but it has yet to be enacted in many others. Principle C17 will provide an incentive for other nations to consider such legislation as well.

[24] Representatives from the International Monetary Fund, INSOL, the IBA, and other international organizations extended their congratulations to the World Bank and UNCITRAL for the important work that has been done. The collaborative

approach that UNCITRAL and the World Bank have taken was highly appreciated. It was commonly acknowledged that the issues of insolvency and creditor rights has become increasingly important to the economy but meanwhile challenging for many countries in the post-crisis era, and that the international community should work on promoting better understanding and wider recognition of the principles and guidelines in insolvency, not only in developing nations but also in mature economies.

The IMF expressed its support for the approach of integrating the World Bank principles and UNCITRAL's work on enterprise groups. The World Bank standards are more comprehensive when supplemented by the UNCITRAL Recommendations, and will afford much needed guidance. UNCITRAL thanked the World Bank for their cooperation.

[25] It was noted by another participant that the UNCITRAL Legislative Guide has already served a valuable purpose in aiding in the drafting of an insolvency law for Afghanistan.

[26] It was also expressed that the UNCITRAL principles should be given close attention in the European Union, as countries there have not only to deal with one another but also with other non-EU countries in the insolvency context. While the European Regulation in Insolvency Law is a useful tool for regulating the handling of cross-border insolvency proceedings pending within or involving various member states, it has no application when assets, liabilities, creditors, related entities, or parallel proceedings are located in non-member states. Some member states (such as the United Kingdom) have already enacted versions of the Model Law for just this purpose.

[27] A cautionary note was offered that some countries may not be ready to actually make use of these sophisticated principles, and that there needed to be proactive efforts to teach, and to develop the necessary structures to use these principles. The World Bank responded that they are in fact being proactive in just this way, but that more can be done. Tailor-made technical assistance for legal and judicial reform would be valuable in these countries. The World Bank, in doing its ICR assessments in developing countries, also provides comprehensive recommendations for a systemic and institutional reform following the World Bank principles, and continues to remain committed to providing such assistance going forward. It was also noted that the Judicial Colloquia sponsored by INSOL, the World Bank and UNCITRAL are an important tool in this teaching and dissemination process.

[28] The idea was also expressed that the principles for enterprise groups set out by both the World Bank and by UNCITRAL might be adapted to groups of financial firms, at least in mature countries, in this post-crisis regulatory environment.

[29] Finally, it was noted that many developing countries need this assistance, and that the mistake that is too often made is to only adopt changes in a crisis. The

World Bank needs to be pro-active, to help countries see this need before the countries themselves perceive that need. Indeed, it was noted that India is only now modernizing its insolvency laws, though it could be argued that it should have been doing that 15 years ago.

An Update on the Continuing Work by UNCITRAL on Insolvency Related Issues

[30] A presentation was then made with regard to the current work of UNCITRAL in the insolvency law arena. There are three. First, the preparation of a judges' book, a descriptive work to aid judges in working with the Model Law, designed especially for use by judges who may not have any familiarity with cross-border insolvency issues. Second, there is the consideration and interpretation of concepts relating to the subject of center of main interests, a concept central to the operation of the Model Law, but which has little elaboration in either the Model Law's Guide to Enactment or in UNCITRAL's other insolvency-related texts. Third, there is the question of D&O liability issues in the insolvency context, a matter of some considerable importance as it touches on the actions that managers might take (or decline to take) in the period before a proceeding is actually commenced. The relative range of perceived freedom of action can dramatically alter manager behavior in the run-up to a formal insolvency proceeding, and so can dramatically affect creditor returns.

[31] The World Bank commented that the work of elaboration on the base concepts relating to Centre of Main Interests (COMI) by UNCITRAL is important and welcome. UNCITRAL can do what no one else can. While there can be a dialogue between national courts, they must necessarily reach fact specific issues that may be unique to their own jurisdiction, making their rulings of more limited value to courts in other countries called upon to construe the same concepts in the context of the Model Law. Guidance from an international body, with a view to greater uniformity, is important. There is a need for guidance to prevent the terminology from becoming too rigid or narrow. But there also needs to be guidance regarding which sorts of proceedings are not appropriate candidates for assistance.

[32] Further elaboration was provided by members of the United States delegation to Working Group V, which had originally proposed the issue for consideration. The delegate member explained that the delegation's reasons for proposing UNCITRAL look at the concepts associated with "centre of main interests" (or "COMI") arose from its concerns that greater predictability is needed with regard to these concepts, as they affect the expected placement of cases and thereby superimpose an involuntary choice of insolvency law on the creditor. It was also noted that, while the concepts need to be flexible so that they can anticipate changes in the financial and insolvency landscape, attention must also be paid to the margins, to prevent abuse. The underlying principle for the Model Law on Cross-Border Insolvency is that the insolvency of an enterprise optimally should be managed in a single forum, even though both assets and liabilities may be located in many other forums. Effective coordination of actions to maximize liquidation and reorganization

proceedings hinges on the pendency of the coordinating insolvency proceeding in the country that is the enterprise's centre of main interests. While substantial deference ought to be paid to the choices made that result in the opening of a proceeding in a given nation, there must also be clearer guidelines that assist a court in deciding whether to decline assistance when the forum selected is clearly not the center of main interests (and is also not a location in which the debtor entity has an establishment), in order to prevent fraud and abuse. UNCITRAL is in a unique position to offer guidance in this regard, in a way that national courts are not.

Conclusion

Both the World Bank and UNCITRAL look forward to continuing their cooperative efforts in the future. In this way, the salutary goals of both international organizations are advanced. Greater harmonization in the area of insolvency law and creditors' rights can lead to greater predictability, to the ultimate benefit of investors, creditors, and employees. That, in turn, can lead to greater trade and investment among a wider spectrum of nations, to the ultimate benefit of their citizenry. Both the World Bank and UNCITRAL look forward to continuing their cooperative efforts in the future.